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Message Text

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43
ACTION EUR-12

INFO OCT-01 EA-07 IO-13 ISO-00 SP-02 USIA-06 AID-05 EB-07

NSC-05 CIEP-01 TRSE-00 SS-15 STR-04 OMB-01 CEA-01

CIAE-00 COME-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03

LAB-04 SIL-01 L-03 H-02 PA-01 PRS-01 /107 W
---------- 069830
R 100912Z AUG 76
FM AMEMBASSY BRUSSELS
TO SECSTATE WASHDC 7654
INFO AMEMBASSY BERN
AMEMBASSY BONN
AMEMBASSY COPENHAGEN
AMEMBASSY DUBLIN
AMEMBASSY LONDON
AMEMBASSY LUXEMBOURG
AMEMBASSY OSLO
AMEMBASSY OTTAWA
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY STOCKHOLM
AMEMBASSY THE HAGEU
AMEMBASSY TOKYO
AMEMBASSY VIENNA
USMISSION EC BRUSSELS
USMISSION GENEVA
USMISSION OECD PARIS

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E.O. 11652: N/A
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SUBJECT: BELGIAN FRANC UNDER PRESSURE AGAIN

REF: BRUSSELS 2833, BRUSSELS 3009

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1. SUMMARY. THE LATEST WAVE OF PRESSURE AGAINST THE BELGIAN

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FRANC IS BEING FOUGHT OFF WITH SOME SUCCESS, BUT AT A HIGH PRICE. INTEREST RATES HAVE BEEN PUSHED UP, CREDIT IS HARD TO OBTAIN (ALTHOUGH DEMAND IS NOT GREAT EITHER), AND FOREIGN CURRENCY RESERVES ARE DWINDLING. THE PRESSURE IS AN INDIRECT CONSEQUENCE OF THE SHIFT FROM US DOLLARS TO DEUTSCHE MARKS BY INTERNATIONAL TRADERS IN THE LAST TWO WEEKS. THE BELGIAN NATIONAL BANK, AND OTHER NATIONAL BANKS IN THE EUROPEAN "SNKAKE" COUNTRIES ALIGNED WITH THE DM, HAVE BEEN OBLIGED TO INTERVENE TO KEEP THEIR CURRENCIES FROM DROPPING BELOW THE 2.25 PERCENT PERMISSIBLE SNAKE MARGIN. EXPERIENCED OBSERVERS IN BELGIUM SAY PRIVATELY THAT THE MOST REASONABLE SOLUTION WOULD BE A REVALUATION OF THE DM OF UP TO 8-10 PERCENT, BUT THEY CANNOT BE CONFIDENT THAT GERMANY WILL AGREE TO REVALUE IN THE NEAR FUTURE (I.E., BEFORE THIS FALL'S ELECTIONS). WHILE PUTTING AS MUCH PRESSURE AS IT CAN ON THE GERMANS TO AGREE TO REVALUE, THE BELGIAN NATIONAL BANK ALSO APPEARS PREPARED TO DEFEND THE BELGIAN FRANC'S POSITION IN THE SNAKE FOR SOME TIME TO COME WITHIN THE PRESENT SNAKE ALIGNMENT IF NECESSARY. END SUMMARY.

2. FOR THE THIRD TIME IN 1976, THE NATIONAL BANK OF BELGIUM HAS BEEN OBLIGED SINCE LATE LAST MONTH TO TAKE STRONG MEASURES TO DEFEND THE VALUE OF THE BELGIAN FRANCE AGAINST SELLING PRESSURE. AS SEEN LOCALLY, THE PRESSURE DEVELOPED AS AN INDIRECT EFFECT OF A SHIFT IN INTERNATIONAL CURRENCY TRADING OUT OF US DOLLARS AND INTO DEUTSCHE MARKS, WHICH IS ITSELF A CONSEQUENCE OF SHIFTING SENTIMENT AMONG MONEY MANAGERS FAVORING HIGHER EARNING POTENTIAL IN THE GERMAN CURRENCY. BELGIUM, STRONGLY COMMITTED POLITICALLY TO REMAINING IN A FUNCTIONING SNAKE, IS BOUND TO KEEP THE FRANC IN STEP WITH THE DM AS IT GAINS RELATIVE TO THE DOLLAR, ALTHOUGH BELGIAN ECONOMIC CONDITIONS IN THEMSELVES FAIL TO JUSTIFY SUCH A MOVEMENT. RECOVERY FROM THE 1975 RECESSION REMAINS SLUGGISH, AS PRODUCTION STILL LAGS IN MAJOR INDUSTRIES (STEEL, TEXTILES) AND UNEMPLOYMENT REMAINS HIGH (8.4 PERCENT). BUT FEARS ABOUT LOSS OF COMPETITIVENESS FOR BELGIAN EXPORTS HAVE YET TO BE JUSTIFIED BY THE TRADE FIGURES--IN BALANCE FOR THE FIRST FIVE MONTHS OF 1976, AN IMPROVEMENT OVER RECENT YEARS. AND THE BALANCE OF PAYMENTS, SHARPLY NEGATIVE FOR THE FIRST QUARTER OF 1976, HAS BEEN POSITIVE SINCE THEN AND MAY END THE YEAR POSITIVE, AS IT ALWAYS HAS SINCE 1969.
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3. THE MEASURES ADOPTED BY THE BELGIAN MONETARY AUTHORITIES (THE NATIONAL BANK AND THE MINISTRY OF FINANCE) HAVE INCLUDED INCREASING THE BANK INTEREST RATE FROM 7 TO 8 PERCENT, RESTRICTING TEMPORARILY (UNTIL 30 SEPTEMBER) THE DISCOUNT CAPABILITY OF BANKS, AND RAISING OTHER NATIONAL BANK RATES TO DISCOURAGE MOVEMENT OUT OF BELGIAN FRANCS. AT THE SAME TIME, THE NATIONAL BANK HAS HAD TO INTERVENE IN MONEY MARKETS

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WHENEVER THE FRANC THREATENS TO DROP BELOW THE SNAKE FLOOR.
THIS IS TURNING OUT TO BE A HIGH PRICE TO PAY FOR MAINTENANCE
OF THE SNAKE CURRENCY ALIGNMENTS. FOREIGN CURRENCY RESERVES
ARE DOWN SINCE THE BEGINNING OF THE YEAR, FROM 109 BILLION
BF TO 72 BILLION BF AS OF AUGUST 2. THE AUGUST 2 WEEKLY
REPORT OF THE NALIONAL BANK SHOWED A NEW INDEBTEDNESS TO THE
FECOM (EUROPEAN MONETARY COOPERATION FUND) OF 1.5 BILLION BF,
AND AN INCREASE OF 4 BILLION BF UNDER "MISCELLANEOUS", ALL OR
MOST OF WHICH IS RECKONED TO BE MORE FECOM ENGAGEMENTS.
THE INTERBANK RATE JUMPED BY 2 PERCENT IN JUST TWO WEEKS.
CREDIT HAS BECOME EXTREMELY TIGHT. SINCE CREDIT DEMAND HAD
SLACKENED CONSIDERABLY IN THE PAST TWO MONTHS, THE IMMEDIATE
CONSEQUENCES OF A CREDIT SQUEEZE ARE UNIMPORTANT, BUT BY SEP-
TEMBER, WHEN ECONOMIC ACTIVITY TRADITIONALLY PICKS UP, A CREDIT
SQUEEZE WOULD FURTHER INHIBIT AN ECONOMIC RECOVERY THAT HAS
BEEN ALL TOO INDECISIVE ANYWAY.

4. THE BEST SOLUTION FROM THE BELGIAN POINT OF VIEW WOULD
BE REVALUATION OF THE DM UPWARDS, EVEN BY AS MUCH AS 8 TO
10 PERCENT. THAT WOULD INCREASE THE COST OF GERMAN IMPORTS
HERE, BUT WOULD HAVE FEW OTHER NEGATIVE EFFECTS, AND IT
WOULD HELP BELGIAN COMPETITIVENESS IN THE IMPORTANT
GERMAN MARKET AND IN COMPETITION WITH GERMAN MANUFACTUREERS FOR
OTHER MARKETS. IT WOULD ABOVE ALL GIVE MORE TIME FOR
BELGIUM TO GET ITS INFLATION RATE (10 PERCENT PLUS) DOWN
CLOSER TO THE GERMAN RATE (AROUND 5 PERCENT) AND COME TO
GRIPS WITH OTHER STRUCTURAL PROBLEMS. BELGIUM HAS
IMPORTANT COMMUNAL ELECTIONS THIS OCTOBER, AND THE
GOVERNMENT HOPES ITS HAND WILL BE STRENGTHENED BY THE
RESULTS SO THAT MORE EFFECTIVE MEASURES CAN BE TAKEN TO
REDUCE INFLATION AND GOVERNMENT DEFICITS, ATTRACT MORE FOREIGN
INVESTMENT, AND CONFRONT THE DIFFICULT NECESSITIES OF REFORM
OF THE INDEXATION SYSTEM AND OF OTHER ARRANGEMENTS CLOSE TO
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LABOR'S HEART (AND PURSE).

5. PEOPLE WE HAVE CONSULTED IN THE BELGIAN FINANCIAL COMMUNITY
THINK THERE IS AT LEAST SOME CHANCE THE GERMANS WILL DECIDE
TO REVALUE AROUND AUGUST 15, WHEN VACATION SEASON IS AT ITS
HEIGHT. BUT THEY ACKNOWLEDGE THAT THE GERMSNS HAVE POLITICAL
CONSIDERATIONS, TOO, AND THEIR GUESSES TEND TOWARD THE VIEW
THAT THERE WILL BE NO GERMAN REVALUATION BEFORE NOVEMBER.
IF THAT VIEW IS CORRECT, THE BELGIANS WIL HAVE TO
DECIDE WHETHER TO DEFEND THE FRANC IN THE SNAKE AT LEAST
UNTIL THEN, OR TO DISENGAGE FROM THE SNAKE AND LET THE FRANC
FLOAT DOWNWARDS, AT LEAST TEMPORATILY, PROBABLY LOSING ABOUT
AS MUCH AS THE FRENCH FRANC HAS RELATIVE TO THE POWERFUL DM.
AT THE BELGIANS SEE IT, IT IS A CHOICE BETWEEN TWO UNPALATABLE
ALTERNATIVES. THE PRESENT MOOD IS TO DEFEND THE FRANC (AND

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CONTINUE TO PRES THE GERMANS THROUGH BANKING AND GOVERNMENT CHANNELS TO "DO THE RIGHT THING"). OUR SOURCES ARE OF THE OPINION THAT THE BELGIANS HAVE THE FINANCIAL RESOURCES TO WITHSTAND THE PRESENT ROUND OF PRESSURE ON THEIR CURRENCY, AND MAYBE ANOTHER ONE AFTER THAT. THE PRICE IS HIGH, AS SHOWN BY PARAGRAPH 2 ABOVE, BUT THEY CAN DO IT IF THEY CONTINUE TO ATTACH GREAT IMPORTANCE TO IT. RENNER

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